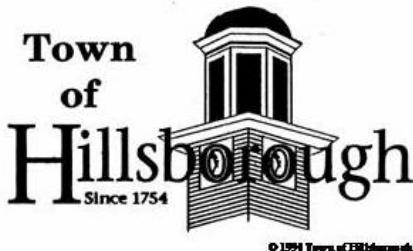


Budget Message



February 23, 2017 (Revised May 17)

Honorable Mayor Stevens and Board of Commissioners:

I am pleased to submit Hillsborough's FY18 Annual Budget Workbook and FY18-20 Financial Plan. For the sixth year in a row, the budget is being presented several months earlier than the traditional delivery date for local governments in North Carolina. This provides additional time to review, deliberate, receive input, consider alternate ideas and make adjustments. To the best of our knowledge, Hillsborough is the only local government in North Carolina (of over 650 cities and counties) that delivers a draft budget this early to its governing board.

The budget is prepared in accordance with the North Carolina Local Government and Budget Fiscal Control Act. As this proposed document is transmitted from the town manager to the Board of Commissioners, it now becomes the governing body's budget to review, debate, adapt and ultimately adopt. It is expected that changes will be made to the proposed budget as proposals and alternatives are discussed. Delivering a budget so early requires ongoing adjustments to revenue and expenditure projections, as new information becomes available, through adoption in June. The manager and staff are ready to provide whatever information the board deems necessary to help it make well-informed decisions on the budget and three-year financial plan.

It is important to note that this first draft is **not** the final word on Hillsborough's budget and financial plan. Rather, it's intended to serve as a "starting point" in a four-month process. Therefore, the mayor, Board of Commissioners, advisory boards and community are strongly encouraged to share their views regarding what should be funded, eliminated, reduced, added, or altered because this is **your** budget!

New for the FY18 Budget Workbook

- **Reduced size.** This "workbook" is a streamlined version of the document the board will receive in May. To make things easier to review, the size of the already large workbook is reduced by not including many of the supplementary sections and appendix that appear in the full-blown May version of the document. This should allow everyone to focus on the higher priority issues.

- **"Top Priority" Maps** have been added to each department's budget section. The purpose of the maps is to 1) identify the one or two most important issues/tasks the department need to accomplish, 2) ensure the department has thought through key actions, steps, and potential threats to success, and 3) ensure the department has the resources needed to be successful. Departments will provide regular progress updates to the town manager throughout the year on their "top priorities" so adjustments can be made as conditions change. There will be an annual review of these priorities, along with the Annual Balanced Scorecard report, each October/November with the town board.
- **Department strategy maps have been eliminated** to make room for the "top priority" maps. The departmental strategy maps information is mostly duplicated in the balanced scorecards, just in a different format.
- **"FY18 Budget on One Page"** executive summary has returned. While the budget message is in a user-friendly format, it's still long and thus discourages many citizens from reading it. This one-page summary allows readers to get a quick overview of the budget's key points in about two minutes.

Why Develop a Detailed Budget so Early?

Answer: Make time an ally, not an adversary. The board will have the advantage of seeing the detailed budget before its Annual Budgetary Planning Retreat on March 11. Early decisions on what issues the board supports, does not support, and where it requires additional information, allows everyone to focus on the highest priority items. This provides more time for developing alternatives, soliciting additional feedback from the public and debating the merits of various options. Starting the process early increases the window of time available to develop better solutions without the counterproductive pressures that can be brought on by a last-minute time crunch. In a normal budget cycle for local governments, only a few weeks are allotted between review and adoption.

The Budget as a Decision-Making Tool

This is the 20th year a multi-year financial planning format has been used in reviewing the town's budget and operations. It is the 11th year the balanced scorecard has been used to implement and communicate the board's mission, vision, strategic priorities and core values. The scorecards are a response to the town board's strategy map through initiatives, performance measures and targets pursued by departments in their daily operations. This system was designed to help the organization become more analytical, adaptive and responsive to the lessons it learns while trying to achieve its goals. Strategies are tested through trial and error via the performance measures in the scorecards.

Budget Message

These businesslike techniques (used by more than half of the Fortune 1,000 companies) determine how to prioritize needs and allocate town resources. While the scorecard is a typical tool in the business world, Hillsborough is one of only about four or five local governments in North Carolina using this system that links goals, actions, measures, and targets. The draft Balanced Scorecard will be delivered to the board in advance of its review at the April 24 workshop and will be included in the final adopted budget.

The multi-year forecasting component of this document encourages the town to look forward to identify, address and mitigate potential problems while they are still manageable. The plan allows readers to better see how today's decisions affect the town's financial condition in the future. The financial plan functions as a "fiscal radar," giving Hillsborough more time to proactively plan responses to problems and needs. This is crucial in avoiding unwanted surprises! Using only an annual budget process, as most local governments do, to manage their financial and departmental operations provides little advance warning of problems looming on the horizon. If the town board, staff, and community is aware of a potential problem in advance, it has greater flexibility and time to develop reasonable solutions calmly.

FY18 BUDGET EXPENDITURES

General Fund	\$ 10,399,638
Stormwater Fund	\$ 601,750
Water/Sewer Fund	\$ 11,704,778
Total	\$ 22,706,166

TAX & RATE HIGHLIGHTS

Property Tax Rate: Reduced from 68 cents to the "revenue neutral" rate of 62.16 cents per \$100 of assessed valuation.

This will be the fifth consecutive year without a property tax rate increase. This is a revaluation year for property tax in Orange County. It is recommended that the tax rate be adjusted to the "revenue neutral" rate so the town brings in the same amount of revenue as it would if the tax values remained the same. Orange County projects property values will increase an average of 14.8% in Hillsborough, yet personal, motor vehicle, and public service values will actual see decreases in the 1% to 7% range. The revenue neutral calculation is included in the document immediately following the budget message.

Water Rates: **No change.** Water rates were last raised five years ago, in July 2012. Increases are projected for Year 2/FY19 (5.0%) and Year 3/FY20 (5.0%).

Sewer Rates: **No change.** Sewer rates were last raised 2 years ago, in July 2016. Increases are projected for Year 2/FY19 (5.0%) and Year 3/FY20 (5.0%).

Stormwater Fee: **No change.**

Vehicle Fee: Increase by \$20. Please see the next section to learn more about the vehicle fee and how it will be used to pay for Hillsborough's street repaving program.

Vehicle Fees & Powell Bill (Gas Tax): A long-term approach to funding street repaving in Hillsborough.

The town currently charges \$10 per vehicle. The North Carolina General Assembly gave local governments the authority to increase these fees up to \$30. The rate has been \$10 for over 12 years. The current fee generates approximately \$50,880 per year, the proposed increase will then yield \$152,640 per year. It's recommended that all these fees be assigned, along with most of the Powell Bill revenues (state gas tax) to help fund the street repaving program. The annual street repaving program is projected to cost about \$380,000 in FY18 and increase over the years to ensure the town repaves about five percent of its streets annually to stay on a 20-year cycle.

Still, these two revenue sources are only projected to generate \$332,640 annually, or 87.5% of what's needed to pay for this key infrastructure priority. This means that General Fund revenues still have to be used to make up the gap. Most municipalities do not 1) maintain/repave their streets on a sustainable schedule, or 2) have a long-term strategy for funding this critical infrastructure need. Assigning vehicle fees and Powell Bill revenues for street repaving provides a long-term strategy to fund this program and protects these funds from being directed to other lower priority needs. The increased vehicle fees also help make up for the loss of the privilege license fee (about \$40,000 annually for the town) that was taken away from municipalities in FY16.

GENERAL FUND – PROJECTS & INITIATIVES

Expenses increase by 5.2% in FY18

- ✓ **Street Repaving** – \$380,000 keeps the town on pace to repave about 5% of streets or on a 20-year cycle. (\$185,000 is funded from the Streets Division and \$195,000 from Powell Bill revenues). In addition, \$32,500 is included to pave Odie Street that was recently annexed.
- ✓ **Public Works Facility Relocation to NC-86 North Property** – current facility is in flood plain, small, old, and in poor condition, with no shelters for equipment. \$1 million is the placeholder cost figure until engineer estimates are available. A \$44,971 debt payment is allocated in FY18. That payment increases to \$89,941 in Year 2 of the plan.

Budget Message

- ✓ North Campus Project – relocates the Town Hall Annex (finance and billing operations) and the Town Barn meeting room functions to the former medical offices located at 101 E. Corbin Street, purchased two years ago. The project converts the current Town Barn meeting room into much needed office space on the Town Hall Campus. Moving the Town Hall Annex allows the police department to temporarily address their needs by occupying this space until the new public safety station on North Churton Street is built. This project also includes improvements to the Town Hall Campus to improve its function as a tourist attraction and recreational space. The placeholder cost for the project is approximately \$1.25 million until design and architectural estimates can be made. Design is currently underway and expected to be completed by the Fall. Annual debt services payments of \$131,133 will be shared between the Finance, Governing Body, Ruffin-Roulhac, Billing & Collections, and Stormwater operations.
- ✓ Fiber Loop - Connect all town facilities via a fiber connection creating a network that makes file sharing and communication between facilities/departments easier and significantly reduces phone and internet costs. Much of this project may be done in partnership with Orange County to share costs and save significant expenses for each organization. This project simultaneously builds a fiber backbone capable of fostering fiber to the home, or "last mile" service, by third party providers. Thus, this project helps attract a high-speed internet provider to serve Hillsborough. The feasibility study was completed in late 2016 and construction cost estimates are currently being developed. \$1.5 million and a 10-year loan with \$184,936 annual debt payments starting in Year 2 (FY19) is a placeholder figure until firmer estimates are available.
- ✓ Police vehicles (10): \$460,000 to replace aging vehicles and implement an Individually Assigned Vehicle Program. The police department is one of the few agencies in the area that does not have such a program and that deficiency makes recruiting and retaining officers more challenging. In addition, during large events there are sometimes not enough vehicles to address key needs. This will also increase police visibility in the community. This will be funded through a five-year installment purchase agreement. An explanation and justification of the program is found in the police budget.
- ✓ Police Radio Replacements: \$70,000 in FY18 replaces about half of the 10-year old radios in the department and includes some additional units for back up and reserve officers. The current models are discontinued, starting to experience failures, and requiring repair on a regular basis. The handheld radios are one of the officers' most

critical pieces of equipment. They are relied on for every aspect of the job and officer safety.

Personnel – New Positions, Merit, Pay Plan, Etc.

- ✓ Police Management/Crime Analyst – the police chief currently performs most of the analytical work including crime analysis, responses to inquiries from various groups, budget, performance measurement, balanced scorecard, top priorities, etc. This is not an effective use of his or the department's resources. The chief needs additional capacity so he can focus on other key priorities. This entry-level analyst position addresses a major gap in the department. It also has the advantage of being filled by a civilian, thus an officer is not being pulled from the street to handle these functions.
- ✓ Fire Inspector (Part-time: 0.2 FTE). Last fiscal year was the first time in many years that not all scheduled fire inspections were addressed. The fire marshal also serves as the emergency management coordinator for the town, conducts arson investigations, plans reviews for new development, and many other key issues. The request for a full-time fire inspector was not funded, but a part-time position (eight hours per week) is recommended.
- ✓ Firefighters – split the cost of three new positions with the Orange Rural Fire Department starting in January 2018. The addition of these firefighter positions has been planned for several years. In addition to addressing current needs, it also is part of a plan to slowly ramp up staffing so there will be enough personnel to operate the new Waterstone Public Safety Station when it opens in a few years.
- ✓ Water Plant Operator/Trainee – Several operators are currently eligible for retirement in this small yet critical division of only 6.5 FTEs. Within four years, five of the seven veteran operators, including the retired part-time operator may have retired. The staff has also been short-staffed for prolonged periods over the past few years. It takes a long time to get an operator trained and familiar with the plant's operations. This position is essential for succession planning and safe operation of the plant.
- ✓ Merit System: 3.25% average raise. General Fund: \$95,000. Water/Sewer Fund estimate: \$35,000.

Budget Message

WATER/SEWER FUND – EXPENSE HIGHLIGHTS

Expenses increase by 5.6% in FY18.

Projects/Facilities/Initiatives

- ✓ Reservoir Phase II (\$8.3 million) – Construction starts June/July 2017 to ensure completion by end of 2018 when permit expires. Delaying this project could double or triple construction cost due to new permitting requirements. The first debt payment is not projected until January 2018. Annual debt payments are projected to be about \$772,000 per year, but only about half that amount will be due in FY18. Fortunately, the two Phase 1 reservoir loans will be retired soon. The last payment on one loan is in FY18 and the other in FY20. So, as the new debt comes on the old debt will be going off the books – that is fortunate timing so as to minimize or have little impact on rates.
- ✓ Main Control Panel Replacement at Water Plant (\$95,000) – The panel is original to the 1972 plant, is heart of the operations, there are occasional problems, and if it suddenly malfunctions it could take the water plant out of operation for an extended period of time.
- ✓ Replace 1993 Dump Truck (\$55,000) with a used but relatively newer model truck to save funds.
- ✓ Design for Expansion of Old Water Plant: Line Crew & Operations Building (\$50,000) – There is currently one bathroom for 17 personnel, only three offices, limited to no central heat/air in parts of the building, and other current and future space needs. Construction is planned for Year 2 (FY19) at approximately \$280,000.
- ✓ Replace 1971 Tanker (\$60,000) – used during emergencies to pump out stations to prevent sanitary sewer overflows. Parts are difficult to find for this 46-year old tanker. Staff will attempt to purchase a used unit to save money.
- ✓ AMI – radio read meter reading system – the first loan payment for this project starts in FY18, \$77,991 per year.
- ✓ Sewer Line Repairs (\$50,000) – Continues annual “inflow & infiltration” reduction program.

Rapid Growth in Progress

There's a lot "happening" in Hillsborough in terms of new development due to an improving local economy and infrastructure being completed for the Waterstone development in late 2015, funded by the Special Assessment District (SAD). The SAD paid for the completion of Cates Creek Parkway, water and sewer lines, and the park. The 2013 opening of medical offices at UNC Hospital site and the 2015 opening of the hospital have continued to drive growth in the southern end of town. Also, residential growth is occurring in many parts of Hillsborough. Many businesses are thriving due to the new development and popularity of Hillsborough as a

tourist and "day-cation" destination. After many years of no growth during the recession, the table below shows Hillsborough is in the process of significant growth.

Approved & Under Construction				
Project name	Approved units	Permitted	Completed	Remaining
Bellevue apartments	114	114	0	114
Cates Creek Apartments	270	270	207	63
Corbin Creek Woods	18	18	18	0
Corbinton Commons (SF only)	70	10	1	69
Elfin Pond	104	44	34	70
Fiori Hill	46	0	0	46
Forest Ridge	233	69	44	189
Lennar townhomes (Waterstone)	200	0	0	200
Waterstone Estates	136	119	99	37
Waterstone Terrace	114	84	62	52
Approved & Under Construction	1305	728	465	840
Pipeline (Approved But Not Under Construction)				
Project name	Approved units	Type		
515 N. Churton St.	24	Condos		
Collins Ridge	1038	Master plan approval only		
Corbinton Commons	141	Senior apartments		
Approved, not under construction	1203			
TOTAL UNITS	2508			

New development is a challenge for the General Fund since the town will not receive property taxes for the full value of new homes occupied today, for almost two years, or until mid-FY19. In addition, the town does not receive property taxes from the hospital. Delayed revenues, yet the immediate demand for services places the town in the challenging position of determining how to prepare for and serve new development in advance of corresponding revenue. The strategy is to use savings (fund balance) to pay for substantive operating deficits in recent years. This gap should start slowing and stabilizing in Years 2 and 3 of the financial plan and become more manageable as property taxes from new development start making it into the budget. This, of course, assumes that new needs and unexpected expenses are managed and manageable with the resources projected.

Unlike the General Fund, assistance to the Water & Sewer Fund from new development is more immediate. Once a new home or business is occupied, revenues from water and sewer bills start immediately. The additional revenue should help stabilize water and sewer rates by taking advantage of currently unused capacity. While new growth is exciting, it will undoubtedly create challenges and demands for services of which we are not aware. This puts a premium on budgetary, financial and operational planning to prepare for this transition.

FY18-20 Budget & Financial Plan Strategy

The pressure of new development in bringing more residents, businesses, and visitors to Hillsborough tests the strategy of assembling a budget that meets current and future demands. In recent years, a simple approach has been used to categorize and help balance the various wants and needs facing our town. In addition to the Town Strategy Map, the three following principles are used as a guide in developing this budget and financial plan:

Budget Message

1. Take care of what we already have!
2. Invest in Hillsborough's future!
3. Minimize rate impacts on the citizens!

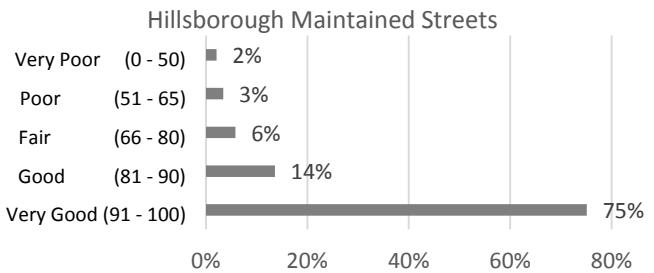
1. Take care of what we already have (infrastructure, equipment, employees, and organizational structure)! The town's mission, vision, strategic priorities and objectives can't be implemented if these basic tools of service implementation are not in working order. The longer a municipality waits to address, repair or replace these assets (tangible and intangible), the more expensive it becomes in the long term. Federal, state and local governments are notorious for building capital assets and not adequately maintaining them. For example, ensuring the organizational structure and resources are in place to maintain parks is equally as important as building the parks themselves. Hence, construction of new assets must be balanced with the personnel, equipment, and organization to operate and maintain them, which is critical in avoiding the overextension of resources.

Most of us have seen reports assigning grades to how well infrastructure is maintained. It's rare when governments receive higher than a "C" for maintaining the most important and expensive assets in their communities. In fact, the American Society for Civil Engineers, in its 2017 update, gives the country's infrastructure an overall rating of a "D+." Updates are done every four years. The chart below shows grades for several areas of infrastructure.



In the past several years, articles have appeared about the struggles of two major cities in the region to keep up with infrastructure maintenance. The repaving cycle for streets in one major city is approximately once every 50 years. Another city projects it is replacing about 0.5 to 1% of its water lines annually. This translates to a 100 to 200-year replacement cycle. As a reference, Hillsborough has succeeded in achieving an approximate 20-year repaving cycle for its streets, after a four-year repaving surge. This is the reason funds are budgeted to repave approximately 5% of the streets annually. This data was confirmed and updated with the January 2015 pavement condition analysis and priority list of streets requiring paving and/or maintenance in the near future.

Pavement Condition Analysis



The Town Engineer/Utilities Director is working on a replacement schedule and age/condition analysis to help track progress on maintaining the overall condition of Hillsborough's water and sewer lines, as well as other key assets (e.g., pump stations, water tanks, generators, etc.). While an exact figure is not available at this time, the town has been aggressive in line replacements and repairs in recent years (e.g., replacement of the Orange Grove Road water main, complete replacement of the water lines in the Riverside and Crawford Road subdivisions, northern and southern loops, and many other projects). Other examples include repairs throughout the wastewater collection system that have significantly reduced inflow and infiltration into the system, such as the recent \$400,000 re-lining of a significant portion of the Eno River sewer outfall. These efforts have dramatically decreased flow into the wastewater treatment plant and many pump stations system wide, especially during periods of heavy rain.

Citizens certainly don't want Hillsborough to fall into the same trap as most other communities and governments in this country. Therefore, committing to ongoing lifecycle cost analysis for key assets and monitoring to properly fund our street, water, sewer and stormwater systems should be a top priority!

A few other examples of "taking care of what we already have" that are included in the budget and financial plan include:

Budget Message

- ✓ Vehicle and equipment replacement: Older vehicles, prone to mechanical difficulties, can interrupt service to citizens and increase operational costs. The most problematic vehicles in all departments will be replaced or placed in reserve status over the next few years. The vehicle replacement schedule can be found at the end of this document in the Supplemental Information section. Overall, the fleet is in excellent condition – this is not a trivial accomplishment and it has taken many years to reach this point.
- ✓ Public Space Division – there have been a variety of problems over the years with mowing contractors damaging headstones at the Old Town Cemetery and Corbin Street Cemetery. The new division created in 2016 streamlines the organizational structure, with the division overseeing not only landscaping/mowing contracts, but also maintaining and improving other key town investments, such as Riverwalk, town parks, public spaces and rights-of-way. Failing to take care of these facilities has potential negative economic impacts, as Riverwalk in particular, has turned into a major tourist generator helping local businesses.
- ✓ Employees:
 - Funding for raises is included at a level that should be similar to that of surrounding local governments.
 - Training continues to be funded as a priority. Many employees have a variety of programs in which they can obtain advanced training and certifications that not only improve their professional skills, but provide for advancement in the organization. Internally, Hillsborough University restarted in 2017. The Hillsborough University Leadership Academy, a robust year-round training schedule developed by Human Resources and Safety on a wide variety of essential topics, the new book club, as well as traditional funding for employees to attend relevant seminars/classes/conferences, and pursue certifications is included in the budget. Employees wanting to further their education are encouraged to do so through the tuition reimbursement program for pursuing a GED, associate, bachelor, or master degree in conjunction with a career development plan. This program recently helped the town attract some high-quality employees.
 - Police department training – The police department has greatly ramped up its training efforts by conducting regular training well beyond what is required by N.C. Training & Standards. The department has adopted an “every day is a training day” motto with training often happening each shift. The recent adoption of the Cognitive Command (C2) training

made Hillsborough the first department in the country to incorporate this as part of their in-service training. C2 and other training initiatives are intended to protect citizens and officers alike. Use of the old furniture store on North Churton is enabling the police department to address a variety of other training needs. The police driver training program and cooperative efforts with the N.C. League of Municipalities earned national recognition in 2016 by being recognized as the winner of The National Law Enforcement Officers Memorial Fund’s Destination Zero award that recognized effective officer safety and wellness initiatives that help drive down risk factors proven to lead to officer injuries and deaths. The program is managed in cooperation with the U.S. Department of Justice’s Bureau of Justice Assistance and its officer safety and wellness initiative. The department was recognized at Police Week in May 2016 along with the New York, San Diego, and Fairfax County police departments.

- Salary survey implemented necessary compensation adjustments in 2016 to stay competitive with the market, recognize employees whose responsibilities had expanded, and maintain internal equity. It addressed problems with recruiting and retaining key positions in the town, especially as starting salaries and/or benefits in the police department had fallen behind other area agencies.
- ✓ Water and Sewer Line Repairs/Replacements: Funding for line replacements and repairs continues, as well as “inflow and infiltration” reduction, and continual TV inspection and cleaning of sewer lines. Future capital improvements are scheduled in the three-year financial plan as well as the seven year Capital Improvements Program.
- ✓ Information Technology – unexpected problems with computers and various IT hardware can cause unnecessary service/productivity interruptions if replacement intervals are stretched too far. The schedule plans to replace most equipment on no longer than a five-year cycle. A performance measure used in the balanced scorecard for the Village of Pinehurst cites percentage of IT equipment less than five years old. Their current percentage was almost 100%. The town’s inventory is found in the Supplemental Information section.

2. Invest in Hillsborough's future! Identify specific projects, programs, services and/or infrastructure improvements likely to make Hillsborough a better place to live, work, visit and start a new business. Sound growth is necessary to support the improvements and services desired by the citizenry, and to make Hillsborough an affordable place to live.

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- ✓ Reservoir and Water Treatment Plant Expansions. Construction is scheduled to start this summer on Phase 2 of the reservoir with completion anticipated by the end of 2018. Design work for the corresponding water treatment plant expansion starts in FY20. These projects provide water capacity to accommodate the type of growth Hillsborough wants and to strengthen the system's drought resistance.
- ✓ Public Works relocation from their current facility, known as "the shed," located in the Eno River flood plain. FY16 and FY17 provided design funds to move public works to the N.C. 86 North property. Construction is funded in FY18 for a new building and vehicle shelters.
- ✓ Old Water Plant (Distribution & Collection Operations): The line crews, assistant utility director, mechanics, and Backflow/FOG specialist all operate out of this facility, a decommissioned 1936 water plant. Currently, 13 employees and 4 inmates share one bathroom. New employees will be added in future years as the town grows. Some offices have no central heat or air-conditioning and rely on space heaters in the winter. Design work is scheduled for FY18 with construction starting in FY19 to provide adequate space and facilities for this critical operation.
- ✓ High Speed Fiber - The IT budget sees a major increase in the financial plan to pursue a fiber network that not only increases efficiency, but provides a return on investment by 1) reducing future phone and internet costs, 2) partnering with Orange County to share costs and save money, and 3) taking the first steps towards attracting a third-party high-speed internet provider to serve the citizens of Hillsborough.
- ✓ Economic Development – An economic development planner was added in late 2015 to assist existing and prospective businesses that want to stay or locate in Hillsborough (e.g., recruitment, trouble-shooting, guidance through permitting processes, etc.). The planner also works to improve communication and coordinates a variety of activities and issues between non-profit, government, and private business interests in the community. In addition, the position provides staff support to both the Tourism Board and Tourism Development Authority. These two boards manage and develop strategy on how best to leverage the use of the occupancy and prepared food & beverage tax proceeds to further drive tourism and other economic development initiatives.
- ✓ Parks
 - Parking improvements at Kings Highway Park.
 - Wayfinding kiosk at Gold Park.

- Adjusting playground equipment to address temperature issues with the slide and other needs.
 - Annual funding for park feasibility studies.
- ✓ Pedestrian Safety/Accessibility Improvements:
 - Complete downtown pedestrian, parking and vehicle traffic improvements including crosswalks, widened sidewalks and a loading zone on West Margaret Lane. These projects are being accomplished via NCDOT funding primarily, with assistance from the town.
 - \$20,000 annually in the three-year plan for small connectivity projects or accumulating these funds to address larger future needs.

3. Minimize rate impacts on the citizens!

- ✓ No property tax, water, sewer, or stormwater rate increases are proposed for FY18!
- ✓ No property tax rate increases are currently forecasted in the three-year plan.
- ✓ Decreasing water costs for low-volume users was accomplished in 2016 via the four-year plan, which started in 2013 to lower the minimum charge from 3,000 to 2,500 gallons per month. This was done without raising rates on customers using above the minimum.

Cost Reduction Benefits

Change From 3,000 to 2,500 GPM Minimum Charge
(*Savings for Customers Using 2,500 Gallons/Month or Less*)

In-Town	Month	Year
Water	\$ 4.04	\$ 48.42
Sewer	\$ 6.07	\$ 72.78
Combined	\$ 10.10	\$121.20
Out-of-Town		
Water	\$ 7.87	\$ 94.44
Sewer	\$ 11.83	\$141.90
Combined	\$ 19.70	\$236.34

GENERAL FUND – Noteworthy Deferred or Unfunded Needs

Additional positions. The list below does not include all requested positions. The ones listed below are considered high priority as funding becomes available. They are not listed in priority order.

- Administrative Support Specialist – assistance to the administration, human resources, town clerk, budget, safety and public information operations. The human resources team is particularly stretched to provide

Budget Message

support and training to employees. The position would also greet the public once the human resources/town clerk offices move to the Town Barn.

- *GIS/Transportation Planner* – The planning department currently has more work than they can complete. While the position would focus on transportation and GIS needs, it would provide support/relief to the planning, public space, and stormwater operations. A critical benefit of the position is that the planning director has limited time to assist with development review. Adding this position would provide a second person reviewing and double-checking development proposals.
- *Community Policing Officer* – The current community policing (COP) program is staffed with a sergeant and one officer. Adding an officer would allow the COP program to take on a more active problem-solving role and a more active role connecting with community members and businesses. This unit would then also be able to provide coverage when patrol officers are out of service for training. Having adequate patrol coverage is a frequent barrier in finding time for training.
- *Facility maintenance technician* - The town has no staff assigned to conduct basic maintenance and repairs at all of its facilities. This task is delegated to staff at each facility. For years, department heads and other key staff have spent a lot of time either fixing problems themselves or finding contractors to do the work. New federal safety regulations (Arc Flash) prohibit employees without training from even changing certain types of light bulbs. The town's utility system electricians and crews often did a lot of work, but they no longer have the time. Hence, the town has used one contractor to handle various work. The annual cost is getting large enough that we are probably getting close to being able to pay for a new position. This would save time across departments.
- *IT Technician* – The budget director has taken on many functions related to IT over the past several years (e.g., liaison with IT contractor, point of contact for employees when many issues arise, phone system upgrades, fiber project, representative on TJCOP IT group, etc.). This has become exceptionally time consuming and the responsibilities keep growing, thus taking time away from budget. Adding a position that would supplement the IT contractor, providing on-site support to town departments, providing a higher level of in-house expertise, and sharing the workload with the budget director are all critical needs, as IT has a direct impact on the productivity of each town operation.
- *Fire Inspector* – The increased rate of development is making it difficult for the fire marshal/emergency management coordinator to complete all inspections and

other duties. FY16 was the first time in many years, if not ever, where 100% of the inspection schedule was not completed. Inspections and building plans reviews are often time-intensive activities. For example: building construction plans (2-24 hours), fire protection systems (2-10 hours), preliminary site plans (1-4 hours), site plans for special use permits and construction (1-10 hours) are some examples of how time consuming key tasks can be.

Projects, Facilities, Equipment

Public Safety Station (fire and police) – Master planning or preliminary design work is delayed until Year 3 (FY20) of the plan, with full design work not scheduled to start until FY21. Work on this facility is delayed until funding becomes available. While new facilities are certainly needed, ensuring solid operations via providing adequate pay, benefits, staffing levels, equipment, training, and the tools needed to do daily jobs are currently a higher priority for police and fire personnel than getting new facilities rapidly. Funds are being set aside in the financial plan from developer contributions to help pay for the initial design work.

Orange Rural Fire Department is leading the effort for a possible joint southern public safety station in the Waterstone Development that includes the police department and Orange County. The town would contribute its two-acre parcel on College Park Drive as well as \$105,000 of developer contributions in a capital reserve fund that have been designated for police capital. These contributions would help fund the inclusion of a police sub-station in the facility. Orange County is also interested in adding an EMS station.

Exchange Club Park – long-term lease where the town assumes maintenance and upgrades to the facility. FY19 costs: \$26,500. FY20 costs: \$36,000.

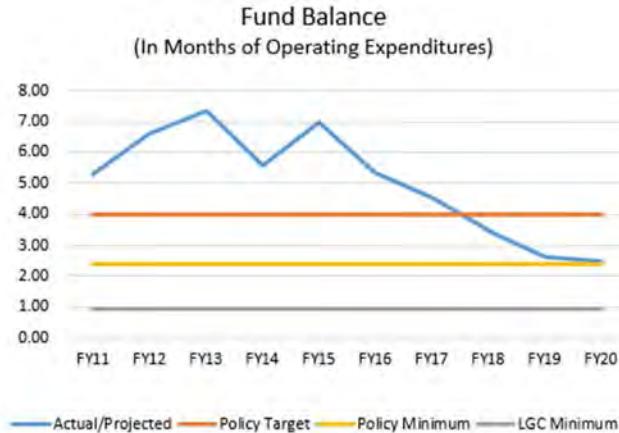
Latimer Boardwalk – (\$131,900) 200-foot walkway over a creek that connects the two dead-ends in the middle of Latimer Street. Residents who live north of King Street and east of Nash Street have no safe pedestrian connection to downtown Hillsborough, as well as to Central and Hillsborough Elementary Schools. It's possible that grant funds might be found to help fund this project, such as Safe Routes to Schools.

GENERAL FUND – FUND BALANCE & REDUCING DEFICITS

The fund balance policy requires a minimal savings level equal to at least 20% of projected expenses, but the preference is to maintain at least 33%, or four months of operating expenses. The fund entered FY17 with a 38% level, which is lower than in previous years. Property tax revenues can be delayed almost two years, depending when a new residence or business receives its certificate of occupancy (CO), yet new citizens require services immediately. To address this challenge, the town manager's approach in recent years has been to use

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more savings than typical to balance the budget. As revenue from new development starts to come in then those fund balance allocations should be throttled back. The town will need to start focusing on rebuilding the fund balance to higher levels in the next few years.



There are several key points to remember regarding fund balance projections from the budget and financial plan:

- ✓ From when staff submits the February budget draft to the updated May version, staff examines ways to reduce the projected deficits and thus increase the fund balance projections. It's important to keep in mind that the purpose of financial plans is not to precisely project dollar amounts, it is to anticipate potential problems and provide ample time to take corrective actions. Hence, it is important that fund balance levels be closely monitored so expenditure cuts and delays can be made if projected revenue growth does not materialize.
- ✓ Due to the conservative approach of trying to under-estimate revenues and over-estimate expenses, most budget years come in noticeably better than projected. Just because the funds are budgeted does not mean departments spend them. This forecasting method is a more cautious approach and has helped the town finish most fiscal years noticeably better than projected when the audit or Comprehensive Annual Financial Report (CAFR) is released. Hence, even without taking any action, the size of the deficits usually decreases significantly in the normal forecasting, budget, and audit cycle.
- ✓ Departments are required to make expenditure estimates for the current fiscal year (FY17) before they've even reached the mid-point. Again, to be cautious they typically overestimate expenses for the current year since it's so early. That in turn increases expense projections for the three-year plan, thus magnifying the impact of this conservative approach on the fund balance projections.

- ✓ Many financial plans have been adopted over the years showing fund balance levels lower than desired levels, yet the town has maintained strong savings for nearly the past two decades. This is one indicator that this approach to financial planning has worked for the General Fund.
- ✓ Since unforeseen needs, challenges, and opportunities always arise in future years, it's important to take the deficits projected in this draft seriously and look for ways to reduce them over the next few months.
- ✓ It's always much easier to add expenses than to cut so the town manager recommends the town board not add any items of significance to the FY18-20 budget and financial plan without first identifying corresponding cuts, deferrals, and/or reductions since the resources have been stretched considerably. When additional funds become available in the future, often via updated information from expense reports and/or the annual audit/CAFR, the board can add items back in the future (e.g., June budget workshop, mid-year or during the preparation of the following year's budget/financial plan).

GENERAL FUND DEBT

Equipment Financing Strategy: Guard Against Overspending

Standard large vehicle and equipment replacements are not included in long-term debt calculations for four reasons:

- 1) Operational in nature.
- 2) Short-term obligations are usually five to seven year loans. Local Government Commission approval is rarely needed for equipment purchases if the term is five years or less.
- 3) Service life of the vehicles/equipment usually far outlast the loan period. While a loan may be five to seven years, the town usually gets at least 10 years of service from a piece of equipment and often 15 – 20 years. In the case of fire trucks, 30 years is standard (20 years front line service, then 10 years as back-up).
- 4) Advantage of amortizing the true annualized cost of capital equipment. This financing strategy is important as it actually provides a preventative control on spending. For example, paying cash for much of the expensive equipment can create "peaks and valleys" in bottom line budget amounts. If not watched closely and failure to use a multi-year plan risks creating the illusion that the "cost of government" is less than it actually is. Thus, governments often misinterpret these "valleys" or years with low overall spending to mean they have more money available to fund new projects, initiatives, and needs. This mirage can cause local

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governments to unintentionally overspend, thus creating greater financial challenges down the road. Hence, the “smoothing” effect of using short-term debt to fund expensive vehicles/equipment provides a more accurate picture of the operational costs and thus makes it easier to determine how much money really is available for new initiatives.

Much of this strategy is dependent on low interest rates. Local governments and businesses have benefited from borrowing money at record lows in recent years. Significant increases in interest rates would likely drive a strategy change incorporating two adjustments:

- 1) Raising the cost threshold of acquisition where debt financing is used (i.e., pay cash more often and save debt for much more expensive purchases). Currently, cash is used to purchase most standard vehicles (e.g., cars and light to medium duty pick-up trucks).
- 2) Create a vehicle/equipment capital replacement fund to pay for the most expensive acquisitions. The fund is started with an initial transfer of funds, then built/maintained each year with an on-going appropriation. This is another way to achieve the expenditure “smoothing” benefits discussed above.

Long-term debt obligations equate to 5.97% of the FY18 General Fund operating budget. This is a healthy amount, as nationally, local governments average 10.7%.

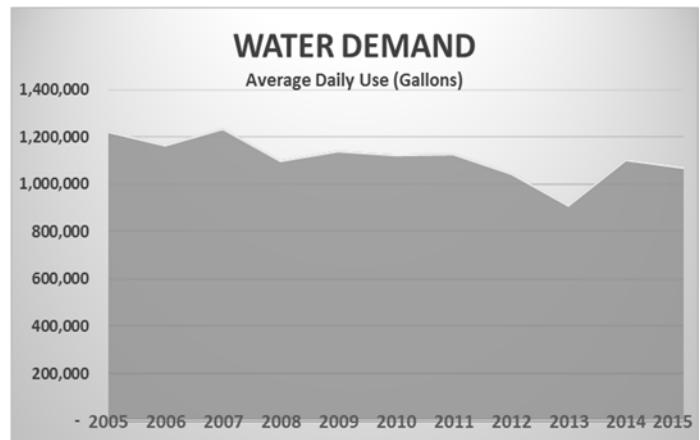
New General Fund debt added for FY18:

- Dump Truck: 5-year loan (short-term)
- Asphalt Roller: 5-year loan (short-term)
- Knuckleboom Truck: 5-year loan (short-term)
- Police vehicles: 5-year loan (short-term)
- Public Works Facility: 10 – 15 years (medium-term)
- North Campus Project: 10 – 15 years (medium-term)

WATER/SEWER FUND

FY15 was the first year in which debt payments (\$1.3 million) were made on the wastewater treatment plant upgrade project. This project more than doubled the budget for this operation but was essential to 1) preventing a moratorium on new development, 2) meeting the stringent Falls Lake Rules imposed by the state, and 3) making a long-term investment in one of the community’s most important assets. As a result, the plant now has some of the cleanest wastewater effluent in the entire country in terms of nitrogen discharge. That is impressive considering the thousands of publicly operated wastewater plants in the United States.

Considering the average national grade for wastewater facilities is a “D”, having a new state-of-the-art plant, while expensive, is a long-term asset for Hillsborough. The national grade for drinking water is also a “D”. The board and community should feel good that the water system (e.g., plant, reservoir, and distribution components) is well cared for and consistently produces clean water. The utilities staff is to be commended for continually looking for ways, often creative, to maintain and improve our system.



Rates, Highlights, Issues and Complications

- Water/Sewer Usage: After over 15 years of declining or flat water usage, an increase in daily demand has finally started. In addition, greater demand appears to be coming in the next few years with various developments in process. It is anticipated this will start providing much needed revenue to the fund. As reported in the 2014 Water Research Foundation’s report, “Defining a Resilient Business Model for Water Utilities,” rates for small systems are often substantially higher than larger systems that can benefit from economies of scale. Hopefully the addition of a significant user base to the water and sewer system will help stabilize rates over the long term.
- New customer accounts should help absorb some of the approximate loss of about 5.8% of sewer revenue in FY18 due to the loss of Efland-Cheeks customers, expected to disconnect from Hillsborough’s system in mid-FY18 (per projections from Orange County staff) and become part of Mebane’s system. These customers generate about \$240,000 of Hillsborough’s sewer revenue. The revenue loss has been included in the sewer rate calculations for the past several years.
- Relief for Low-Volume Users: The minimum charge for monthly water and sewer service decreased in 2016 – dropping to 2,500 gallons per month in FY17. A monthly minimum charge between 2,000 and 4,000 gallons is common among utilities. Due to Hillsborough’s high rates,

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especially for out-of-town customers, this minimum charge can be a costly expense for customers who use far less than the minimum. In addition, this billing methodology has raised legitimate equity concerns, especially regarding customers whose water use is well below the minimum. The minimum charge also provides no incentive for these customers to conserve.

The Board of Commissioners and Water Sewer Advisory Committee (WSAC) have studied a variety of options over the past decade on how best to address this issue. Both bodies set a goal of reducing the minimum monthly charge from 3,000 to 2,500 gallons. Reducing the minimum charge means reducing revenue, a projected \$330,000 annual revenue loss by going from a 3,000 to 2,500 minimum. The change has been phased in via the four-year plan listed below:

- FY14 — 3,000 to 2,800 gallons
- FY15 — 2,800 to 2,700
- FY16 — 2,700 to 2,600
- FY17 — 2,600 to 2,500

- Solid Financial Reserves (Savings). The retained earnings level for the Water/Sewer Fund is projected to remain within policy through the three-year financial planning period, projected to end FY20 at 24 percent. **This is considered a strong and healthy level!** Keeping the savings amount over the 25 percent target (or three-month level) should be a goal in future years. This has become more challenging with the addition of the wastewater plant debt increasing the overall budget, thereby requiring a larger amount of retrained earnings to maintain the same level of savings. Maintaining a strong savings level is critical to continue 1) keeping most to all of the financial dashboard readings in the “green,” and to 2) having good credit factors and/or bond rating since a long-term installment-purchase agreement or revenue bonds will likely be used to fund the Phase II reservoir expansion in FY17.
- Water & Sewer Fund: Outlook Beyond FY18. The current flurry of growth has allowed the use of associated capital facility fees to contribute towards debt payments on facility expansion projects like the wastewater plant, reservoir, and other projects. Using capital facility fees to help balance the budget in recent budgets and the next few years has helped stabilize rates. This will be especially helpful as there will be about two years of overlapping debt on the reservoir (e.g., debt on the \$8.3 million Phase II project will overlap the final two years on Phase I in FY18 and FY19).

Capital facility fees are helping “smooth” this expenditure spike and prevented recent rate increases. While using these fees, \$500,000 in contributions from the

Waterstone developers many years ago to help pay for the new southern water tank, and retained earnings (savings) to serve as a bridge to get through the next few years until the customer base expands sufficiently to better support the operational needs is helpful, but it’s only a short-term or temporary strategy.

If revenues don’t increase sufficiently in the latter half of FY17 and FY18, there will likely need to be water and sewer rate increases in Years 2 and 3 of the financial plan. The forecast currently calls for five percent increases per year, for both water and sewer, in Years 2 and 3 to start weaning the fund off the temporary use of retained earnings and capital facility fees. This is critical as there are several major projects coming just outside of the three-year planning window requiring additional funding.

In controlling costs and minimizing rate impacts going forward, it’s important to not just look at the revenues and water/sewer operational expenses, but also costs that are shared with the General Fund and charged to the Water/Sewer Fund. Any expenses in Governing Body, Administration, Ruffin Roulhac (such as the North Campus Project), Finance, Fleet, and Safety impact the Water/Sewer Fund. So, care in watching expenses in these areas is important as they affect the bottom line in the Water/Sewer Fund.

Fortunately, revenue projections from water and sewer sales for FYs18-20 are quite conservative at two percent per year. So, if as often happens, income is greater than expected combined with expenses coming in well under budget the situation may be better than is currently forecasted. Regardless, this is an area that will require close monitoring over the next few years to maintain the fiscal health of the fund, address top operational needs, and minimize or avoid possible rates increases.

WATER/SEWER FUND – DEFERRED & UNFUNDED NEEDS

While there are plenty of items cut or deferred at the operational, divisional, and department level in every budget process, the following requests were considered justified by the manager, but deferred due to financial limitations:

- ✓ Distribution & Collection – two (2) entry-level property maintenance positions to focus on mowing and maintaining outfalls and other sites, assisting with bi-annual flushing, valve exercise program, and other needs. During the recent boil-water advisory situations on Orange High School Road, due to some staff being out, the crews were short-handed and this made responding even more challenging. It takes years of experience to become an effective utility maintenance technician. Someone just can’t be hired, quickly learn how the distribution and collection system operate, and know what to do in critical

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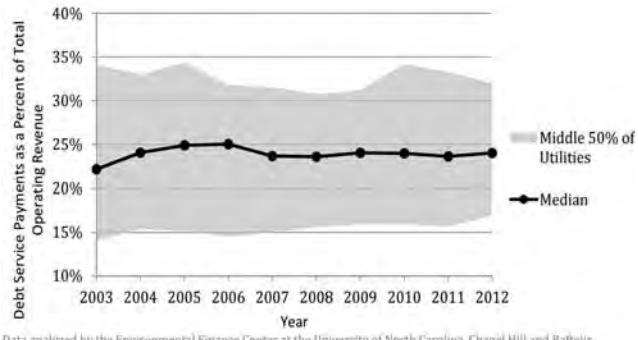
situations. Hence, adding entry-level positions provides relief to current staff and effectively serves as an “apprenticeship” essential to succession planning in the department.

- ✓ Utility Clerk for Distribution & Collection – there is no one consistently able to answer the phone at this facility. Inventory management, creating a database of inventory, getting quotes on orders, being a liaison with other departments, handling customer issues, and other administrative tasks would improve handling of these matters and free staff to focus on other tasks.
- ✓ Water treatment plant expansion design – delay the start until FY21. This will increase the capacity from 3 to 4.5 million gallons per day (MGD).

Water/Sewer Fund Debt

The recent CAFR/audit references the ratio of long-term debt to operational expenses at about 30%. The graph below, using data from Moody's rating agency (compiled by the UNC Environmental Finance Center and Raftelis Financial Consulting), shows the debt percentages for the middle 50% of a sampling of systems. While 30% is definitely high, it's still well within standard practice. Other data recently reviewed found over 600 utility systems showed a large number operating in the 35% – 55% range.

Finance and/or budget staff will provide a more detailed analysis of this and other financial metrics over the next year. This will be done via the benchmarking and dashboard reports comparing Hillsborough to similar jurisdictions that staff does most years. There is a wide variance on debt levels carried by water and sewer systems in the United States. While lower is definitely better, assuming that a system is being properly maintained, there are many fiscally healthy systems where a high percentage of the budget is allocated to long-term debt.



Debt is an important financial factor to monitor and consider when making budgetary decisions. Like many factors in operating an enterprise or governmental fund, there is no one right answer or set of standards to follow. Hillsborough's utility

system certainly is carrying more long-term debt than one would ideally like to see. With that said, the Water & Sewer Fund has been faced with a broad array of challenges in maintaining its capital assets. The choice was essentially to let these assets decay and get more expensive to repair over time or be proactive to 1) keep the system in good working order, and 2) prepare for the future.

Several benefits were obtained using longer-term debt to address critical system needs like construction of the reservoir to ensure adequate water capacity, water plant upgrade, wastewater plant upgrade, various water and sewer system upgrades/maintenance needs, and constructing a new water tank. It's critical to note that all of these improvements were financed with 10 – 20 year loans. While considered "long" term debt, many other systems use 30 – 40 year loans to finance improvements. Debt certainly can be a bad word. However, it offers several advantages if done wisely on long-term assets:

- ✓ Makes needed improvements more affordable.
- ✓ Financing an asset with a life much longer than the term of the loan helps spread or amortize the cost to more accurately reflect the true cost of operations. This is similar to the General Fund equipment debt discussion earlier about protecting from overspending, especially on lower priority items. For example, the Hassell Street water tank is about 80 years old. The quality of construction is nowhere near the new tank in Waterstone. Hence, taking 20 years to pay off the loan is not a relatively long period when compared to an asset that may last 100 years.
- ✓ Spreading the cost over time allows future customers and citizens of Hillsborough to pay their fair share of the assets they will use, whether it be water/sewer infrastructure, parks, police and fire stations, etc.).
- ✓ Limits the burden on current customers.

STORMWATER FUND

A separate Stormwater fund and fee was created in FY17 to fund approximately \$1.1 million in improvements to comply with Stage I of the Falls Lake Rules, required by the State of North Carolina, over the next five to seven years to protect and restore the lake's water quality. The fund will also pay for in-town Stormwater and drainage system maintenance.

What Does Stormwater Cost in Other Cities and Towns?

Stormwater utility fees are currently charged by about 60 other municipalities in the state. A 2013 survey of these jurisdictions cited the average residential charge as \$47.82 per year. The following are stormwater utility fees from some of Hillsborough's surrounding neighbors:

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- Butner - \$67
- **Burlington* - \$60
- **Chapel Hill* - \$26.16 – 156.90 (middle tier \$78.45)
- Creedmoor - \$107
- Durham - \$39.12 - \$162.24 (middle tier \$81.00)
- **Graham* - \$12*
- Raleigh, \$24-\$174 (middle tiers: \$60 and \$102) annually
- Stem - \$88
- *Hillsborough* - \$75

* These municipalities do not have to comply with the more restrictive Falls Lake Rules

Stormwater Expenditure Highlights

- ✓ Stormwater infrastructure (\$172,500) – system maintenance, repairs, projects, inspections, cost share projects with property owners, and street sweeping. Prioritize high priority needs and develop plans to address water quality and drainage issues throughout town. Cornwallis Hills has had a number of problem areas that are planned to be addressed, as well as other areas of town.
- ✓ Capital Projects (\$59,790) for Falls Lake nutrient reduction, as well as reserves for future projects.
- ✓ Monitor revenues and adjust operational and capital expenses during the first year of the fund's operations.

Closing

Quality of Life, Superior Services, Community Safety, and Strategic Growth are listed on the Strategy Map as the town board's Strategic Priorities. The FY18-20 budget and financial plan is full of programs, initiatives, and resources intended to carry out the 17 strategic objectives. These objectives, listed on the Strategy Map, serve as the foundation of the town's Balanced Scorecard that drives operational priorities throughout the year.

There is no one right path to achieving goals, especially in dynamic environments. Hence, questions, deliberation, alternate suggestions, and debate on prioritization of the limited resources is an essential part of effective budget and operational planning. In addition to input from the town board and employees, feedback from the advisory boards, citizens, business community, and other key stakeholders is an important part of helping achieve long-term strategic priorities.

Key dates: this document will first be discussed at the March 11 budgetary planning retreat, departmental balanced scorecard reviews are scheduled for the April 24 workshop, and the first formal budget workshop/public hearing will be held on May 22. If necessary, a second workshop will take place on June 5. Adoption is scheduled for June 12, but can take place as late as June 30.

Please do not hesitate to contact me, Budget Director Emily Bradford or Assistant to the Town Manager Jen Della Valle if you need additional information. Town staff will make every effort to respond quickly and objectively to help you develop a budget that you feel best addresses the needs of the community!

Sincerely,



Eric J. Peterson
Town Manager